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SUBJECT: MARKET FIRMS ON Q1 GROWTH

REF: ANKARA 4061

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1. (SBU) Summary: Turkish markets rebounded on July 1, helped by strong growth figures for the first quarter and a perception that relations with both the U.S. and IMF are on a positive track, following announcements of both a July 9 IMF mission and FM Gul's impending visit to Washington. The Treasury's July 1 auction met its revenue targets, providing more than enough cash to meet its USD 4 billion July 2 redemption. The government's privatization program also received a boost on June 30, with the privatization council's decision to okay the sale of the state petrochemical company (Petkim) to the controversial Uzan family's Standart Kimya. The move surprised most market analysts, who had expected the council to veto the deal. End Summary.

Positive Auction

2. (SBU) After weakening in recent days on worries about delays in implementation of Turkey's IMF program, markets firmed on July 1 as they took new heart from perceived positive developments in relations with both the U.S. and IMF. Announcement that an IMF team will come to Turkey on July 9 to continue work on the fifth review reassured investors that a break with the fund is not on the near term horizon, while indications that FM Gul will visit Washington in the near future also provided hope that U.S.-Turkish relations are mending. Markets benefited too from strong growth figures for 2003's first quarter, which at 7.4 percent growth in GNP came in above analysts' expectations.

3. (U) The positive sentiment enabled the Treasury to meet its revenue targets in a July 1 auction and stockpile the necessary reserves to meet its 5,681 trillion lira (USD 4 billion) July 2 redemption to the market. The government sold 4.178.3 trillion lira of 413-day debt at a maximum yield of 50.96 percent, and 1,904.9 trillion lira in 140-day debt at a maximum yield of 44.5 percent. The yields were close to market expectations, but volume exceeded expectations, as total net sales reached 6,848 trillion lira, including non-competitive bids and sales to public institutions. With the total exceeding tomorrow's redemptions, some analysts predict a lira shortage in coming days that could lead the lira to appreciate further from its July 1 close of 1.409 million to the dollar. Only the stock market did not strengthen on July 1, as it slipped slightly to 10,749, down 1.24 percent, in part as Petkim shares declined following approval of its privatization (see below).

4. (SBU) Global Security's chief economist Cem Akyurek told us markets have basically concluded that there will be no break in the IMF program: the government will continue to negotiate, and at the end of the day will "do the minimum necessary" to keep things on track. Akyurek added that more importantly "everything else is going well," with progress on EU legislation and government determination to take on corruption. Adding to Turkey's attraction are the limited number of equally profitable alternative investment opportunities. As a result, some foreign money is returning to the country, a decision eased by the market's belief that there is no reason for the lira to weaken below 1.45 million to the dollar in coming months. As a result, foreign investors figure they can clear 7-8 percent in dollar terms over the summer, a figure that cannot be matched elsewhere.

As for the long bond, one of the longest maturity papers issued by Turkey since 2001, Akyurek noted its attractiveness as a benchmark issuance with a high degree of liquidity, and the opportunities investors expect it to provide for capital gains, provided that interest rates continue to decline. That attractiveness was reflected in a total bid volume of 7,587.8 trillion lira.

Petkim Approved

15. (SBU) Meanwhile, in a development that surprised most market analysts, the Privatization High Council (PHC) set aside concerns about the fitness of Uzan-owned Standart Kimya and approved its purchase of the state petrochemical company, Petkim. Controversy had surrounded the issue, given the Uzans' notoriety and government concerns about the purchase price (reftel). The council apparently concluded, however, that the Uzans' earlier dealings with the Privatization Administration (PA) were blameless, and that there was no legal impediment to the sale. The decision gives the PA a good start on its ambitious USD 4 billion revenue target for the year, as it prepares for the sale of the state refinery (TUPRAS) and alcohol-tobacco monopoly (TEKEL). It also provides a first sign that in contrast to previous governments that paid lip service to the importance of privatization but did little in practice, this government is actually prepared to carry it out.

16. (SBU) Newly released Central Bank figures highlight the extent of the bank's activity in recent months. Dollar purchases in May-June totalled USD 2.115 billion, as the bank sought to limit volatility in the market and accumulate reserves. The bank announced that it will increase its daily purchases to USD 40 million a day in July, for a monthly total of USD 880 million
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